

# ***STATE OF MONTANA***

## **Public Employees' Retirement Board**

*A Component Unit of the State of Montana*

## **Comprehensive Annual Financial Report**



**For the Fiscal Year Ended  
June 30, 2007**

**Public Employees' Retirement System - Defined Benefit Retirement Plan**

**Judges' Retirement System**

**Highway Patrol Officers' Retirement System**

**Sheriffs' Retirement System**

**Game Wardens' and Peace Officers' Retirement System**

**Municipal Police Officers' Retirement System**

**Firefighters' Unified Retirement System**

**Volunteer Firefighters' Compensation Act**

**Public Employees' Retirement System - Defined Contribution Retirement Plan**

**Deferred Compensation (457) Plan**

**Prepared By:  
The Fiscal Services Bureau  
Public Employee Retirement Administration  
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Helena, MT 59620-0131  
(406) 444-3154**

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### *Mission Statement of the PERB*

*The Montana Public Employees' Retirement Board will fiduciarily administer its retirement plans and trust funds, acting in the best interest of the members and beneficiaries.*

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### *Mission Statement of the MPERA*

*The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement.*

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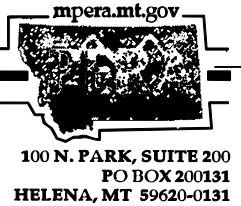
## PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION



BRIAN SCHWEITZER  
GOVERNOR

STATE OF MONTANA

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December 10, 2007

The Honorable Brian Schweitzer  
Governor of Montana  
Room 204, State Capitol  
PO Box 200801  
Helena, MT 59620-0801

Dear Governor Schweitzer:

The Public Employees' Retirement Board (PERB) and its staff, the Montana Public Employee Retirement Administration (MPERA), are pleased to submit this *Comprehensive Annual Financial Report* (CAFR) for the fiscal year ended June 30, 2007, in accordance with 19-2-407, Montana Code Annotated. The purpose of this letter is to introduce the basic financial statements and provide an analytical overview of the trust funds' financial activities.

The management of Montana Public Employee Retirement Administration assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. This CAFR was prepared in conformance with the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board, including the Management's Discussion and Analysis (MD&A). Defined benefit and defined contribution transactions are reported on the accrual basis of accounting. The MD&A, beginning on page 19, is a management discussion of the financial position of the retirement plans. It provides an overview and analysis of the plans' basic financial statements. This letter of transmittal is intended to complement the MD&A and the two should be read in conjunction.

### ORGANIZATIONAL STRUCTURE AND REPORT CONTENTS

The PERB is a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity. For this reason, the financial statements contained in this report are also included in the State of Montana's *Comprehensive Annual Financial Report*. Fiduciary responsibility for the systems rests with the PERB, which consists of seven members, appointed by the Governor. The members are assigned five-year, staggered terms. The Board is required to approve a final budget before the beginning of the fiscal year. The MPERA management develops the budget for all plans administered and presents it to the Board. As gov-

## INTRODUCTORY SECTION

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erned by statute, the Board's defined benefit administrative expenses may not exceed 1.5% of the total defined benefit plan retirement benefits paid. Costs for the Board to administer the defined contribution plans are included as part of the administrative expenses of the plans. The budget is monitored throughout the year and quarterly updates are provided.

The Public Employees' Retirement Board administers ten separate retirement plans, each reported in this CAFR. They include the *Public Employees' Retirement System-Defined Benefit Retirement Plan* (in its 63<sup>rd</sup> year of operation) and *Public Employees' Retirement System-Defined Contribution Retirement Plan*, *Judges' Retirement System*, *Highway Patrol Officers' Retirement System*, *Sheriffs' Retirement System*, *Game Wardens' and Peace Officers' Retirement System*, *Municipal Police Officers' Retirement System*, *Firefighters' Unified Retirement System*, *Volunteer Firefighters' Compensation Act* and the *Deferred Compensation (457) Plan*. The CAFR is divided into the following five sections:

- an *Introductory Section*, which contains the table of contents, this letter of transmittal, administrative organization, and legislative highlights;
- a *Financial Section*, which contains the report of the Independent Auditors, the Management's Discussion and Analysis, the financial statements of the PERB, the notes to the financial statements, certain required supplementary information and supporting schedules of administrative expenses, investment expenses and payments to consultants;
- an *Investment Section*, which contains a report on investment activity, investment policies, investment results and various investment schedules;
- an *Actuarial Section*, which contains the Actuary's Certification Letter and the results of the latest actuarial valuation; and,
- a *Statistical Section*, which includes significant data pertaining to the plans.

The pages that follow report the facts and figures that are the result of dedicated work, new initiatives, improved processes and continuing efforts made to meet the needs of our customers. We trust that you and the members of the plans will find this CAFR helpful in understanding the retirement plans.

## ECONOMIC CONDITION AND OUTLOOK

The economic outlook of the plans is based primarily upon investment earnings. For fiscal year 2007, the PERS-DBRP experienced a 17.96 percent rate of return, for the last three years an average annualized rate of return of 11.64 percent and for the last five years an average annualized rate of return of 10.97 percent. The plans are required by law to be maintained on an actuarially sound basis which protects participants' future benefits.

The positive returns in fiscal year 2007 and the legislation passed in the 2007 Legislative Session to address the unfunded liability of PERS, SRS and GWPORS countered the negative affect on earnings of the bear markets of 2001 and 2002. Although recovery has been slow, we anticipate that over the long-term the earning rates will continue to meet the actuarial assumed rate of 8 percent.

## INTRODUCTORY SECTION

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Effective July 1, 2007, House Bill 131 addressed the funding issue by increasing employer contributions and/or setting a new Guaranteed Annual Benefit Adjustment (GABA) for new hires on or after July 1, 2007. An explanation of House Bill 131 can be found in the Legislative Highlights of the *Introductory Section* beginning on page 14.

The actuarial valuations for the eight defined benefit plans, dated June 30, 2007, show all the plans to be actuarially sound, with one plan having an Unfunded Credit. The amortization period for the Unfunded Liability (Actuarial Surplus) for the defined benefit plans, as of June 30, 2007, are as follows:

PERS	21.9 years	GWPORS	11.3 years
JRS	30.0 years (Actuarial Surplus)	MPORS	20.5 years
HPORS	19.1 years	FURS	12.9 years
SRS	19.6 years	VFCA	5.1 years

The PERB contracts with consultants for professional services, which are essential to the effective and efficient operation of the plans. A listing of consultants the PERB has contracted with can be found on page 89.

The investments of the pension trust funds are governed, primarily, by an investment standard known as the “prudent expert principle.” The prudent expert principle is constitutionally and statutorily mandated and establishes a standard for all fiduciaries, which includes anyone having authority with respect to the pension trusts. The prudent expert principle states that fiduciaries will discharge their duties solely in the interest of the trust funds’ participants and beneficiaries and with the degree of diligence, care and skill which prudent experts would ordinarily exercise under similar circumstances in a like position. By following the prudent expert principle and permitting further diversification of investments within a fund, the fund may reduce overall risk and increase returns. The prudent expert principle permits the PERB to establish an investment policy based upon certain investment criteria and allows for the delegation of investment authority to the Board of Investments (BOI), Department of Commerce. The statement of investment policy outlines the responsibility for the investment of the funds and the degree of risk that is deemed appropriate for the trust funds. Investment officers are to execute the investment policy in accordance with statutory authority, the PERB’s policy and their respective guidelines, but are to use full discretion within the policy and guidelines. A summary of the asset allocations can be found in the *Investment Section* of this annual report.

Pension trust funds are well-funded when there is enough money in reserve to meet all expected future obligations to participants. The PERB’s funding objective is to meet long-term benefit promises through contributions that remain approximately level as a percent of member payroll. The greater the level of funding, the larger the ratio of assets accumulated to the actuarial accrued liability and the greater the level of investment potential. The advantage of a well-funded plan is participants can see assets that are committed to the payment of benefits. A detailed discussion of funding is provided in the *Actuarial Section* of this annual report.

## INTRODUCTORY SECTION

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The *Statistical Section* of this annual report includes the five objectives according to GASB 44: financial trends, revenue capacity, debt capacity, demographic and economic information and operating information, and incorporates statistics regarding retirees and employers contributions, assets held and benefits/distributions paid.

The PERS-DCRP was implemented July 1, 2002. New hires of the PERS have the option of choosing participation in either the defined benefit retirement plan (DBRP) or the defined contribution retirement plan (DCRP). University employees also have a third option of joining the Optional Retirement Program (ORP) administered by the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF New York, NY).

All new hires are offered Plan Choice Educational workshops funded by a percentage of employer contributions. Education to our members and employers is a top priority. We continue to add workshops and member services through our website.

The fiscal year 2007 accomplishments of MPERA are: actuary process improvements; automation of the DROP member processing; database changes through use technology to automate processes for accounting. The Retiree database has additional security and technology was used to automate processes.

### CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montana Public Employees' Retirement Board for its comprehensive annual financial report for the fiscal year ended June 30, 2006. This was the ninth consecutive year that the Montana Public Employees' Retirement Board has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government entity must publish an easily readable and efficiently organized *Comprehensive Annual Financial Report*. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe our current *Comprehensive Annual Financial Report* continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

### PUBLIC PENSION COORDINATING COUNCIL PUBLIC PENSION STANDARDS AWARD

MPERA has also received the Public Pension Coordinating Council (PPCC), Public Pension Standards Award for 2007 in recognition of meeting the professional standards for plan design and administration set forth in the Public Pension Standards. Public Pension Standards were established in 2002 to reflect minimum expectations for public retirement system management and administration. The Standards serve as a benchmark by which to measure public defined benefit plans. All public retirement systems and the state and local government that sponsor them are encouraged to meet the Standards. This is the third time MPERA has received this award.



## INTRODUCTORY SECTION

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### ACKNOWLEDGEMENTS

The compilation of this report reflects the efforts of the fiscal services bureau accounting staff of the Montana Public Employee Retirement Administration. This report is intended to provide complete and reliable information to facilitate the management decision process, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the funds of the plans. As in the past, MPERA received an unqualified opinion from our independent auditors on the financial statements included in this report. This opinion provides assurance that the financial statements can be relied upon. The independent auditor's opinion letter can be found on page 17.

The reporting employers of each retirement system form the link between the plans and the members. Their cooperation contributes significantly to the success of the plans. We hope the employers and their employees find this report informative.

We would like to take this opportunity to express our gratitude to the staff, the advisors and the many people who have worked so diligently to assure the successful operation of the plans.

Respectfully submitted,

*/s/ Roxanne Minnehan*

*/s/ N. Jay Klawon*

Roxanne Minnehan, Executive Director  
Montana Public Employee Retirement Administration

N. Jay Klawon, President  
Public Employees' Retirement Board

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Montana Public Employees' Retirement Board

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director



**Public Pension Coordinating Council**  
**Public Pension Standards**  
***2007 Award***

Presented to

**Montana Public Employee Retirement Board**

In recognition of meeting professional standards for  
plan design and administration as  
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of State Retirement Administrators (NASRA)  
National Conference on Public Employee Retirement Systems (NCPERS)  
National Council on Teacher Retirement (NCTR)

A handwritten signature in black ink, reading 'Alan H. Winkle'.

Alan H. Winkle  
Program Administrator

## INTRODUCTORY SECTION

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### Public Employees' Retirement Board

*A Component Unit of the State of Montana*



Photo courtesy of Kim Flatow

Back Row: John Nielsen, Jay Klawon, and John Paull.  
Front Row: Elizabeth Nedrow, Robert Griffith, Troy McGee, and Terrence Smith.

**N. Jay Klawon**, President  
Hamilton  
Investment Experience  
Investment Representative  
Edward Jones  
Term Expires 3/31/2009

**Troy McGee**  
Helena  
PERS Retired Member  
Term Expires 3/31/2008

**Terrence Smith**  
Bozeman  
PERS-DCRP Active Public  
Employee  
Financial Officer  
Big Sky Water & Sewer  
District  
Term Expires 3/31/2009

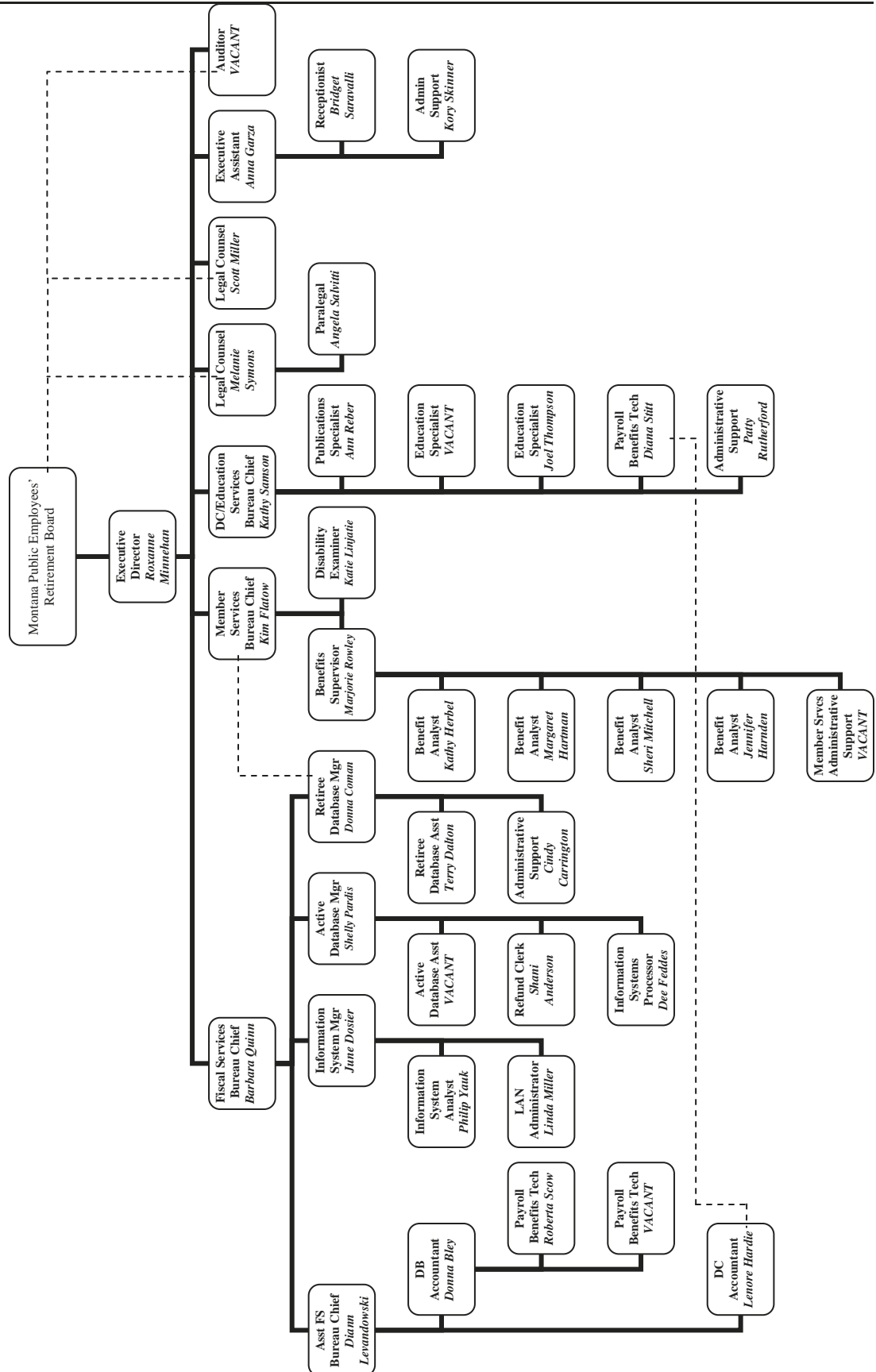
**John Paull**, Vice President  
Butte  
Active Public Employee  
Fireman  
Term Expires 3/31/2010

**Robert Griffith**  
Helena  
Member at Large  
Term Expires 3/31/2008

**John Nielsen**  
Glendive  
PERS Active Public  
Employee  
Term Expires 3/31/2012

**Elizabeth Nedrow**,  
Past President, Resigned  
Billings  
Member at Large  
Attorney  
Holland & Hart  
Term Expires 3/31/2011

Public Employees' Retirement Board  
A Component Unit of the State of Montana  
MPERA Organizational Chart



## INTRODUCTORY SECTION

### *2007 Legislative Highlights*

#### **General Revisions for all Systems — House Bill 129**

Every legislative session, MPERA proposes changes to clarify statutes and to ensure Internal Revenue Code qualification. The general revisions bill, effective October 1, 2007, highlights are:

- **PERS Membership for Appointed Officials:** Elected officials have the right to become a member of the Public Employees' Retirement System (PERS). Amendments to §19-3-412, MCA, ensure that individuals who are appointed to fill the unexpired term of an elected official have the same opportunity.
- **Changes to Required Distributions:** Currently, if a terminated non-vested member has between \$200 and \$5,000 on account, MPERA must distribute the retirement account. Starting October 1, 2007, §19-2-602, MCA, will require distribution of amounts between \$200 and \$1,000 only. The account will be paid directly to the member unless the member elects to rollover the account to another eligible retirement plan. Balances of less than \$200 are paid directly to the member.
- **Working Retirees:** Retirees who return to public service through a professional employer arrangement, a leased employee arrangement, or as a temporary service contractor are subject to working retiree hour and earning limitations. These are:
  - √ PERS working retirees are limited to 960 hours in a calendar year.
  - √ The 60-day limitation for the Sheriff Retirement System (SRS) working retirees will change to 480 hours in any calendar year starting October 1, 2007.
  - √ Effective July 1, 2007, FURS retirees will also be able to work 480 hours before impacting retirement benefit. (Senate Bill 532).
  - √ No other systems provide for working retirees.

Working retirees may not return to employment covered by their retirement system until they have terminated employment for at least 30 days, been paid all compensation owed, and received at least one retirement benefit check.

#### **Rural Fire Districts May Elect to Join Firefighter's Unified Retirement System (FURS) —Senate Bill 532**

Effective July 1, 2007, rural fire districts can pass a resolution to participate in the Firefighters' Unified Retirement System (FURS). Current employees have 180 days from passage of the resolution to elect to join FURS. Employees hired after passage of the resolution automatically become members of FURS.

## INTRODUCTORY SECTION

### 2007 Highlights (continued)

Rural firefighters who transfer to FURS will have three options for their PERS account:

1. Leave their PERS account intact;
2. Transfer their PERS account balance and receive proportional service in FURS; or
3. Transfer their entire PERS account balance and pay the actuarial cost to retain the same service they had in FURS.

### Retirement Systems Funding for PERS, SRS, and GWPORS — House Bill 131

The regular 2007 legislature addressed the unfunded liability in PERS and SRS by 1) increasing employer contributions and 2) setting a new Guaranteed Annual Benefit Adjustment (GABA) for new members hired on or after July 1, 2007. Employee contribution rates do not change. The unfunded actuarial liability in GWPORS was addressed solely through changing the GABA for new members.

### Increase in Employer Contributions

Employer contributions for PERS and SRS will increase in two phases; the first on July 1, 2007, and the second on July 1, 2009. The charts below show the employers' current contributions, increased contributions, and total contributions by employer type.

The increased contributions will end on July 1 immediately following an actuarial valuation determining that 1) the required amortization period is less than 25 years and 2) stopping the increased contributions will not cause the amortization period to exceed 25 years.

### Public Employees' Retirement System (PERS)

	June 30, 2007 Contributions	Phase 1 - July 1, 2007		Phase 2 - July 1, 2009	
		Increased Contributions	Total Contributions	Increased Contributions	Total Contributions
State and University Employer Contribution Rate	6.9%	0.135%	7.035%	0.27%	7.17%
Local Government Employer Contribution Rate	6.8%	0.135%	6.935%	0.27%	7.07%
STATE Contribution for Local Governments	0.1%	0.0%	0.1%	0.0%	0.1%
School District* Employer Contribution Rates	6.8%	0.0%	6.8%	0.0%	6.8%
STATE Contribution for School District Employers	0.1%	0.135%	0.235%	0.27%	0.37%

\*School Districts are defined as K-12

### Sheriffs' Retirement System (SRS)

	June 30, 2007 Contributions	Phase 1 - July 1, 2007		Phase 2 - July 1, 2009	
		Increased Contributions	Total Contributions	Increased Contributions	Total Contributions
Employer Contributions	9.535%	0.29%	9.825%	0.58%	10.115%

## INTRODUCTORY SECTION

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### **2007 Highlights (continued)**

The employer contributions in PERS are increased for members of both the Defined Benefit (DBRP) and the Defined Contribution (DCRP) Retirement Plans. The increased contributions for the DCRP will be allocated first to pay down the Plan Choice Rate Unfunded Actuarial Liability and then to the long-term disability plan trust fund.

#### **Guaranteed Annual Benefit Adjustment (GABA) for New Members**

All PERS, SRS and GWPORS members who are hired or assume office on or after July 1, 2007, will be eligible for a 1.5% Guaranteed Annual Benefit Adjustment (GABA) when eligible for retirement and receiving a benefit under the systems' defined benefit retirement plans. The GABA changes do not affect current PERS, SRS and GWPORS members, whether active, inactive or retired. The GABA for Judges' Retirement System (JRS), Municipal Police Officers' Retirement System (MPORS), Firefighters' Unified Retirement System (FURS) and Highway Patrol Officers' Retirement System (HPORS) will remain at 3% for both current and new members.

#### **Defined Contribution Retirement Plan Loan Paid — House Bill 125**

House Bill 125 was introduced on the PERB's request to pay off the PERB's loan to fund the implementation costs of the Defined Contribution Retirement Plan (DCRP). The legislation creating the DCRP did not provide implementation funding; therefore, the PERB obtained a loan for those expenses. The loan was being repaid through a portion of the annual administrative fee assessed to DCRP participants. House Bill 125 passed by an overwhelming majority and was effective April 28, 2007. MPERA paid off the loan on May 8, 2007, using the appropriated funds, thus preventing an increase in administrative fees due to escalating loan payments.

#### **Annual Actuarial Valuations and Reporting Requirements — House Bill 771**

This legislation requires the PERB to retain a competent actuary who is an enrolled member of the American Academy of Actuaries and who is familiar with public systems of pension. This legislation also requires the PERB to contract for annual actuarial valuations of the retirement plans instead of the previous biennial valuation. The PERB shall annually at a public meeting present to the Board of Investments (BOI) a financial and actuarial report of the retirement systems and brief the BOI on any benefit changes being considered by the PERB that may affect trust fund obligations.

#### **House Joint Resolution 59**

While considering retirement proposals, the 2007 Legislature faced many issues, including retirement system actuarial soundness, employer objectives, employee retirement savings and the interest of Montana's taxpayers. These competing considerations led to the passage of House Joint Resolution 59 (HJR 59). The Resolution requests the Legislative Council to designate an appropriate interim committee to study state retirement systems and produce a guide for the next Legislature.